based on inaccurate data—would provide incentives for cost reduction because the carrier would bear the financial consequences of cost increases, rather than simply collecting additional support funds. However, for the reasons stated in the answer to Question 45, such a model is considerably worse than a proxy model based on publicly verifiable data.

Competitive Bidding

49. How would high-cost payments be determined under a system of competitive bidding in areas with no competition?

The best approach is for the Commission to adopt interconnection policies that promote facilities-based competition so that this problem will not arise. Hence, the Commission should be wary of either explicitly or implicitly loading embedded costs, common costs, and universal service contributions into interconnection charges levied on competitive local exchange carriers by incumbent local exchange carriers.

In those areas where there is no competition, the Commission should set payment ceilings based on information generated by proxy models as well as by the winning bids from auctions held for those areas in which there is competition. Information from these auctions could be used to calibrate and cross-check the proxy models. The proxy models, in turn, could be used to make adjustments to the winning bids from competitive auctions so that these bids could be used to set payment ceilings in uncompetitive areas. For example, a proxy model might indicate that costs are $5.00 per month higher in a particular area in which there is no competition than in the most comparable area subject to competitive bidding. The amount of the subsidy for the uncompetitive area might then be set at the level of the winning bid in the competitive area plus $5.00 per month.

50. How should a bidding system be structured in order to provide incentives for carriers to compete to submit the low bid for universal service support?

AirTouch supports the use of market-based incentives, including auctions. AirTouch believes that it is premature to design the specifics of the auctions, but is confident that the Commission has the demonstrated expertise to run successful auctions.

51. What, if any, safeguards should be adopted to ensure that large companies do not bid excessively low to drive out competition?

Policy makers should reject any attempt to discourage aggressive bidding for universal service support funds Price floors are antithetical to the workings of competitive markets The central goal of competitive bidding is to reduce support levels needed to attain a given level of service by encouraging firms to bid prices down to the underlying service costs and to engage in innovation to reduce these costs.[35] Floors on support levels would undermine the competitive process and the benefits it can bring

Fears of widespread predation through bidding for universal service support are misplaced. There is no reason to suspect such predation will be successful or profitable. A much greater threat to competition comes from actions by ILECs to raise rivals' costs by overstating ILEC support needs

While there is little reason to expect that large companies will accept excessively low universal service support levels in order to drive out competition, there may be a problem where firms underbid and then try to renegotiate their support levels after the competitive bidding process has ended The Commission should make it clear

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35 *See supra* Comments of AirTouch Communications, Inc. at 12-13.

that companies will have to honor their commitments. A similar issue arises with respect to service quality, and it is addressed in the answer to Question 52.

52. What safeguards should be adopted to ensure adequate quality of service under a system of competitive bidding?

The service quality level has to be part of the bidding process. One approach is for policy makers to specify a quality level in advance and have firms then bid to provide the specified level of service at least cost. Another approach is to let service providers submit multi-dimensional bids, stating both the price and the service quality that they are offering. This second approach requires some means of scoring the tradeoff between price and quality so that one could choose, for example, between two bids where one had a higher price and higher quality than the other. In order to facilitate multiple rounds of bidding in an open process, the scoring system would have to be well-defined and publicly known.

Benchmark Cost Model (BCM)

57. Should the BCM be modified to include non-wireline services? If a wireless technology proves less costly than wireline facilities, should projected costs be capped at the level predicted for use of wireless technology?

If a wireless technology proves less costly than wireline facilities, then projected costs should be capped at the level predicted for use of the wireless technology. Failure to do so would inefficiently inflate the costs of providing universal service, both diminishing the effectiveness of the program and increasing the burden levied on telecommunications subscribers and providers.

It also is important to recognize that cellular and PCS technologies may not be the wireless technologies of choice for the provision of fixed local loop services. The

relatively small cell sizes associated with these technologies may not be economically efficient in many rural areas. Moreover, there is no reason to incur the costs inherent in a hand-off capability when users are not mobile. Thus, fixed technologies like BETRS and DECT may be much more efficient.

This brief discussion of alternative wireless technologies highlights the difficulty in mandating the use of wireless technology for the provision of universal service; it would be extremely hard for policy makers to determine which technology is the best one for a given situation. Fortunately, there is no need to do so. With the continued investment in cellular telephony and the build out of PCS, wireless provision of two-way voice services is becoming highly competitive. Given the opportunity to receive universal service funds on a competitively and technologically neutral basis, wireless providers will compete vigorously for funding in those situations where their technologies are the most efficient ones to use.

As a general matter, support mechanisms should rely on economic incentives (*e.g.*, explicit subsidy payments), rather than regulatory fiat (*e.g.*, orders to carriers to provide service). The use of financial incentives ensures that policy makers are aware of the costs of any particular initiative. Moreover, they provide a safety valve against particularly inefficient policies because carriers will choose not to provide service where policy makers have dramatically underestimated its cost and have set the support levels too low. In contrast, when carriers are ordered to provide service, little information about the cost of universal service programs is generated, and high-cost, low-benefit programs may persist. Finally, the use of regulatory fiat inevitably leads to a *quid pro quo*

of being protected from competition in some other service in order to generate subsidy funds.

SLC/CCLC

69. If a portion of the CCL charge represents a subsidy to support universal service, what is the total amount of the subsidy? Please provide supporting evidence to substantiate such estimates. Supporting evidence should indicate the cost methodology used to estimate the magnitude of the subsidy (e.g., long-run incremental, short-run incremental, fully distributed).

In answering the question of whether the CCL charge supports universal service, one must distinguish between intention and effect. While the CCL charge is intended to promote telephone subscribership by reducing the flat monthly charge the consumers pay for service, there appears to be no evidence that it has this effect. Economic theory and evidence suggest that the suppression of subscribership due to the resulting increase in toll rates largely, if not completely, offsets any benefits from the lowering of the monthly charge.[36]

One still is left with the question of what service triggers the costs recovered through the CCL charge. The costs of the local loop are triggered by a consumer's decision to connect to the PSTN. The economic principle of cost-causation as the basis of efficient pricing thus indicates that the costs of the loop should be recovered through a flat

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[36] This view is supported by the experience in the long distance market, where price reductions associated with decreased access charges led to a significant stimulation in traffic. Moreover, the introduction of the subscriber line charge does not appear to have reduced subscribership rates. For a discussion of the estimated effects of price changes on telephone penetration *see* J. Hausman, T. Tardiff, and A. Belinfante, "The Effects of the Breakup of AT&T on Telephone Penetration," *American Economic Review*, 1993.

monthly charge. Hence, *the entire amount of the CCL charge represents a subsidy* from interstate toll subscribers to either ILEC shareholders, employees, or customers.[37]

70. If a portion of the CCL charge represents a contribution to the recovery of loop costs, please identify and discuss alternatives to the CCL charge for recovery of those costs from all interstate telecommunications service providers (e.g., bulk billing, flat rate/per-line charges).

Contributions toward universal service support constitute a tax levied on telecommunications users and providers. The effects of this tax on consumer welfare and competition must be fully considered in designing a new universal service contribution scheme. As noted in AirTouch's Reply Comments in this proceeding, these considerations lead to the conclusion that the Commission should raise the SLC to provide contribution from non-targeted groups. There is no sound policy reason not to increase the SLC for most consumers and have explicit subsidies for low-income consumers. Failing adoption of this policy, the Commission should levy a uniform per-minute surcharge on all retail telecommunications services.[38] To the extent the Joint Board believes that a transition from the current system should be gradual to avoid disruptive shocks, this could be done by phasing-in increases to the flat charge on end users and retaining a per-minute mark up that is gradually phased out. At a minimum, the SLC should be indexed for inflation (*e.g.*, the Consumer Price Index).

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[37] This analysis includes common line long-term support payments but ignores the revenues associated with the provision of payphone service because such revenues will be phased out of CCL charges pursuant to the 1996 Act.

[38] The Commission should consider netting-out inter-carrier payments of this tax along the lines discussed in footnote 39 with respect to the distinction between the gross and net revenues tax bases

There is a significant drawback inherent in any approach that relies on traffic-sensitive charges to attain contribution. Because these charges are traffic sensitive, they can be expected to distort end user calling decisions, reducing the benefits generated by the PSTN. This problem is a real one, as evidenced by the effects of access charge reform over the past decade and the significant stimulation of long-distance traffic that accompanied falling service prices.

The Commission may nonetheless choose to continue levying universal service taxes on a traffic-sensitive basis. While any traffic-sensitive basis for levying these taxes will give rise to the inefficiencies just discussed, some bases are better than others. Although many of the commenters in this proceeding called for the use of service revenues[39] as the base for assessing contribution burdens, AirTouch believes that it would be more appropriate to assess burdens based on minutes of traffic.

A tax on revenues is essentially a telecommunications sales tax. It has the same effect on end-user prices as raising suppliers' costs. Unfortunately, it raises these costs in a way that is neither competitively nor technologically neutral. Problems of technological and competitive neutrality arise when carriers compete with each other using different technologies to provide differentiated services, such as when one set of carriers offer a high-cost, premium service and another set of carriers offer a low-cost, basic service. A revenues tax will raise the costs of the premium service by more than the costs

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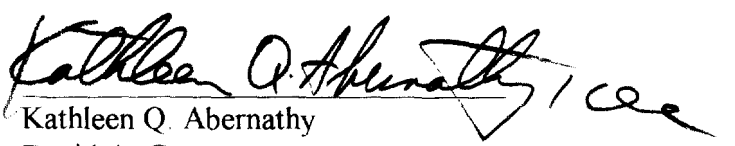
[39] AirTouch agrees with the large number of commenters who have pointed out that the use of a gross revenues tax suffers from a problem of double taxation. In the event the Commission decides to use a measure based upon revenues, the use of net revenues—which backs out payments to other telecommunications providers on whose services the tax already has been collected—is preferable to the use of gross revenues.

of the basic service, and consumers may no longer be willing to purchase the premium service when each is priced at cost plus the tax. Moreover, a revenues-based tax can create inequities among consumers living in different areas. As shown in AirTouch's earlier reply comments in this proceeding,[40] a contribution based on either gross or net revenues may place the lowest burdens on subscribers in the lowest-cost areas.

If a uniform per-minute universal service surcharge were placed on all telecommunications traffic, it would not have the problems of competitive and technological non-neutrality. Moreover, it would lead to each service bearing a relatively small burden, rather than some services taking on a disproportionately large burden. Further, in contrast to a revenue basis, a per-minute basis would not collect the least contribution from consumers with the lowest cost of service.

Respectfully submitted,

AIRTOUCH COMMUNICATIONS, INC.

By: 

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40 *See supra* Reply Comments of AirTouch Communications, Inc. 13-15.

CERTIFICATE OF SERVICE

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